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Supreme Court of the United States

October Term, 1977

No. 76-1835

IKE SLODOV,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

BRIEF OF PETITIONER

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OPINIONS BELOW

The opinion of the Court of Appeals for the Sixth Circuit is reported at 552 F.2d 159, 77-1 USTC Par. 9328 (6th Cir., 1977). The opinions of the District Court are unofficially reported and are found at 74-2 USTC Par. 9719 (N.D. Ohio, 1974); and 75-2 USTC Par. 9829 (N.D. Ohio, 1975), respectively. A copy of each of the opinions below has been included in the Appendix for the Court's convenient reference.

JURISDICTION

The judgment of the Court of Appeals for the Sixth Circuit was filed on April 5, 1977, and within ninety (90) days of that date, on June 23, 1977, a petition for a writ of certiorari was filed. On October 3, 1977, this Court granted Petitioner's request for a writ of certiorari. This Court has jurisdiction under 28 U.S.C.A. Sec. 1254(1).

STATUTORY PROVISIONS INVOLVED

United States Code Annotated, Title 26:

Sec. 6671. Rules for application of assessable penalties.

"(b) Person Defined.—The term 'person', as used in this subchapter, includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs."

Sec. 6672. Failure to collect and pay over tax, or attempt to evade or defeat tax.

"Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 for any offense to which this section is applicable."

Sec. 7202. Willful failure to collect or pay over tax.

"Any person required under this title to collect, account for, and pay over any tax imposed by this title who willfully fails to collect or truthfully account for and pay over such tax shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more

than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution."

Sec. 7343. Definition of term "person".

"The term 'person' as used in this chapter includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs."

Sec. 7501. Liability for taxes withheld or collected.

"(a) General rule.—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

"(b) Penalties.—For penalties applicable to violations of this section, see sections 6672 and 7202."

Sec. 7701. Definitions.

"(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

"(1) Person.—The term 'person' shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation."

QUESTIONS PRESENTED

1. Whether personal liability under 26 U.S.C.A. Sec. 6672 (Internal Revenue Code Section 6672) may result to a person who was not a responsible party at the time withholding and collection of trust fund taxes were effectuated, but is a responsible party at some later time when funds acquired thereafter become available in sufficient amount to pay such taxes?

2. Whether a trust on later acquired funds arises in favor of the United States under 26 U.S.C.A. Sec. 7501 (Internal Revenue Code Section 7501) or any other legal authority for unpaid trust fund taxes for prior periods?

3. Does a responsible party become personally liable by not paying such outstanding liabilities out of later-acquired funds when, at the time he became a responsible party, there were no funds then available to pay any part of such outstanding trust fund taxes or any other liability?

STATEMENT OF THE CASE

Petitioner purchased all of the shares of Tas-Tee Corporation (the "Corporation") on January 31, 1969, and on the same day assumed control and command of the Corporation. At the time Petitioner assumed control there were unpaid trust fund taxes owing to the United States for various quarters ending in 1968 totaling about $177,000.00. In fact, however, when Petitioner took charge

of the Corporation, there were then no funds available to pay any part of the unpaid taxes or other debts. In fact, there was a bank overdraft (A. 33). Such taxes have not been paid.

Operating funds generated by the business of the Corporation after January 31, 1969, were used to pay current taxes and other operating expenses. On or about June 4, 1969, Slodov withdrew from the Corporation's direction. Thereafter, Slodov entered into a proceeding for a Real Property Arrangement under Chapter XII of the Bankruptcy Act.

In the course of the Bankruptcy proceedings, Internal Revenue Service filed various claims against Petitioner as a responsible officer of the Corporation for unpaid trust fund taxes for the period prior to January 31, 1969. The Bankruptcy Judge who heard this controversy held that Petitioner was not a responsible officer of the Corporation prior to January 31, 1969, since he was not responsible for the withholding, accounting for and payment of such taxes. He could, therefore, not be held liable under Internal Revenue Code Section 6672 for unpaid trust fund taxes arising prior to that date.

On appeal, the District Court upheld the Bankruptcy Judge's finding that Petitioner was not a responsible person for unpaid taxes arising prior to January 31, 1969.

The Court of Appeals for the Sixth Circuit, in turn, reversed the District Court's decision. It held that Petitioner was a responsible officer against whom a penalty could be assessed for unpaid taxes arising prior to January 31, 1969. The Court of Appeals remanded the case to the District Court for a determination of the exact amount of liability arising as a result of its decision.

ARGUMENT

Sections 3102(a) and 3402(a) and (d) of the Internal Revenue Code of 1954, as amended (Title 26, United States Code Annotated), impose an obligation upon every employer to withhold federal income and social security taxes from the wages of its employees. Section 7501(a) provides that the amount of taxes so withheld, shall constitute a special trust fund in favor of the United States:

> "Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States."

The term "any person" as used in Section 7501 means the employer, whether the employer be an individual, a trust, estate, partnership, association, company or corporation. See Section 7701(a)(1).

In the event an employer violates its statutory obligations under Section 7501(a), Section 7501(b) refers to Sections 7202 and 6672 for the imposition of penalties. Section 7202 imposes a *criminal* penalty on those persons (separately defined in Section 7343), who may have caused the violation. Section 6672 imposes a *civil* penalty on those persons (separately defined in Section 6671(b)), who are responsible for the violation. Both definitions of "person" are identical in wording.

Section 6672 was enacted to provide the United States with an alternate means of recourse of collecting certain taxes by imposing a one-hundred percent (100%) penalty on those persons, other than the employer, responsible for withholding, collecting and paying over such trust fund taxes on behalf of the employer. In this connection, Section 6672, providing for the above described penalty, in part, says:

> "Any person required to collect, truthfully account for, and pay over such tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over."

Congress, in enacting Section 6672, was apparently interested in protecting the revenue and intended that the taxes constituting the trust fund be fully collected from those responsible persons who may have caused any diversion thereof. The category of "persons" Congress intended to hold responsible are plainly defined in Section 6671(b) to include "an officer or employee of a corporation . . . who as such officer, employee . . . is under a duty to perform the act in respect of which the violation occurs." Thus, the combined impact of Sections 6672 and 6671(b) may be paraphrased as follows: Any officer or employee of a corporate employer who is under a required duty to collect, truthfully account for, and pay over any tax, who willfully fails to collect such tax, or truthfully account for and pay over such tax shall be liable to a penalty equal to the amount of the tax not collected, or not accounted for and paid over.

In the instant case, the United States seeks to cause the Petitioner to pay the amounts owed by the corporate employer for its violations of Section 7501. The alleged violations for which the one-hundred percent (100%) penalty is sought relates to so-called trust fund taxes arising in periods prior to February 1, 1969.

The relevant facts of this case are not disputed and are clearly stated in the record.

The first question which must be answered is whether Petitioner is a person described in Section 6671(b) who can be held personally liable under Section 6672 for the corporate employer's violation of Section 7501. Petitioner respectfully submits that the answer to this question is no.

The imposing language of Section 6672 is unmistakable. It reads: "Any person required to collect, truthfully account for, *and* pay over . . ." [emphasis ours]. Clearly, this Petitioner was under no duty to collect and account for the taxes in question. His association with the corporate employer did not commence until some time long after collection of the taxes were due and, in fact, withheld. Thus, to subject Petitioner to personal liability under Section 6672, this Court would have to read the clear and precise wording of that Section so that its imposing requirements read in the disjunctive rather than in the conjunctive. This is precisely the argument of the United States. The United States, here, does not argue that the Petitioner was a "person required to collect, truthfully account for, and pay over" trust fund taxes relating to liabilities arising prior to February 1, 1969. Rather, it argues that even though Petitioner was a person required only to "pay over" such moneys, he became personally liable therefor when he became a "responsible officer" of the corporate employer at some subsequent time when the employer *acquired* funds out of which pre-February 1, 1969 trust fund taxes could have been paid. Other courts have consistently refused to rewrite Section 6672 in this manner. In *McCullough v. United States,* 462 F.2d 588, 72-2 USTC Par. 9558 (5th Cir., 1972) the court addressed itself to this issue and rejected the argument of the United States. The court, in part, said:

> "The government here contends for a position which would, in effect, change the language of Section 6672 from 'person required to collect, truthfully account for, and pay over' to 'person required to collect, truthfully account for, [or] pay over.'
>
> • • • • •
>
> "The principal difficulty with this argument is that this is not the way the statute is written and there is no statutory authorization for the collection of this penalty. . ."

In order to counter the argument that the imposing requirements of Section 6672 must be read in the conjunctive and not in the disjunctive, the United States sometimes cites the cases of *Teel v. United States,* 529 F.2d 903; 76-1 USTC Par. 9190 (9th Cir., Jan. 5, 1976) and *Tiffany v. United States,* 228 F. Supp. 700, 64-2 USTC Par. 9501 (N.J., 1963), in which the courts held that a taxpayer who was a responsible officer during the collection procedure, but who was removed from that status prior to the date on which the amounts *were required to be paid over,* could be held liable under Section 6672. The United States has misread these cases. All three elements required to charge the taxpayer with the penalty—the requirements of collection, reporting and paying—all did in fact converge. While the taxpayer was removed as a responsible officer before the time payment was required *to be made,* he nevertheless came under the *requirement* of making the payment when he collected the taxes.

See *Tiffany, supra,* which states:

> "In re Serignese, D. C., 214 F. Supp. 917, supports the view that payment to employees made plaintiff inchoately or contingently liable for the penalty before adjudication, since the *liability for paying withheld*

taxes does not accrue on the date for paying them." [emphasis ours].

See also *Teel, supra*:

"Appellants also make the more limited argument that they cannot be charged with a willful failure to pay over the taxes accrued during the month of November because the time of payment did not arise until after the receiver was appointed. As the employer withholds taxes from the employees, a contingent liability is created. The liability merely becomes fixed on the date when the payments are due. Thus the liability for the tax withheld from November 1 through November 23 attached to the appellants at the time they withheld the tax."

The United States argues that any responsible officer of a corporation acquiring available funds to pay a delinquent withholding type tax obligation for a prior period is obligated to earmark and use those after-acquired funds for the payment thereof, whether or not he was a responsible officer at the time the taxes in question were withheld or at the time they should have been paid over, and that willful failure to do so renders him liable under Section 6672. The United States refers to this argument as its "trust fund theory," and the Sixth Circuit, in the proceedings below, has deferred to it:

"When the corporation came into possession of funds after Dr. Slodov acquired control, these funds were impressed with a trust to the extent of the corporation's obligations for previously unpaid withholding income taxes and employees' share of social security taxes. Though created before Dr. Slodov's control of the corporation began, these obligations continued after that date, and he was clearly the person responsible for paying them when funds became available."

The difficulty with the so-called "trust fund theory" is that there is no statutory authority for it. The Sixth Circuit did not cite authority for its conclusion, and the court in *McCullough, supra*, although not directly resolving the issue, seems to reject the notion:

". . . we do not decide the liability of a person who becomes an officer responsible for the payment of withheld but not accounted for and not paid withholding and FICA taxes at a time when the corporation has funds from which the managing head of the corporation could discharge the defaulting corporation's trust obligation to the government and exercises his control to disburse such trust funds for other purposes."

• • • • •

". . . there is no statutory authorization for the collection of this penalty, *even though the taxpayer had free funds available for the purpose of paying the taxes.*" [emphasis ours].

Section 7501 does not sanction the creation of an impressed trust on after-acquired funds. Section 7501 is specific in its reach. It says that the special fund held in trust for the United States is only ". . . the amount of tax so collected or withheld. . . ." [emphasis ours]. Interestingly, not even the Internal Revenue Service recognized the validity of the United States' "trust fund theory." Its agent instructed Petitioner to use after-acquired funds entering the corporation's coffers to discharge then currently arising tax and other obligations before such funds were used to liquidate prior outstanding liabilities (A. 2-3; 15-17).

Assuming arguendo that an impressed trust is engrafted on subsequent funds under the thrust of Section 7501, there is no authority which imposes personal liabil-

ity upon Petitioner. Section 7501 standing alone does not do it because its use of the term "person" refers only to the employer. And certainly Section 6672 does not reach Petitioner for the reasons already discussed. Finally, if Petitioner is to be viewed as a successor trustee to the "trust" created under Section 7501 and to which the "impressed funds" relate, he cannot be held personally liable to the United States for defalcations and other breaches of trust committed by his predecessor trustee. See RESTATEMENT OF TRUSTS, Sec. 223. This is so because at the time Petitioner assumed his status as successor trustee, there were no funds whatsoever constituting trust corpus out of which he could make good the defalcations.

There are responsible officers of the delinquent corporate employer against whom the United States may appropriately seek recourse for the alleged violations. However, this Petitioner is simply not that "person."

CONCLUSION

For these reasons, the judgment and opinion of the Sixth Circuit Court of Appeals herein appealed from should be reversed.

Respectfully submitted,

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